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TAX REFORM PROPOSALS AT THE ILLINOIS CONSTITUTIONAL CONVENTION

The main problems in Illinois taxation have resulted from the enforced adherence to an unregenerated general property tax. The requirement in the present constitution that taxes on property shall be levied "by valuation, so that every person and corporation shall pay a tax in proportion to the value of his, her, or its property" has stood in the way of the adoption of a scheme of classification of property with taxation at different rates for each class and has also rendered impracticable projects for income taxation at progressive rates. If Illinois is to keep pace with the progress of other American states in taxation matters by establishing a co-ordinated system of property and income taxes, it must amend its constitution.

The Committee on Revenue, Taxation, and Finance, of the Illinois Constitutional Convention, after many hearings, much lobbying and discussion, and the rejection of many freak proposals, submitted to the Convention in July, 1920, a majority report and two minority reports, embodying proposed substitutes for the revenue article of the present constitution.¹ The Constitutional Convention is soon to reconvene, when it will presumably take final action upon these proposals. The important provisions of the majority proposals may be summarized as follows:

1. The General Assembly is to be authorized to classify intangible property for taxation, and to tax different classes of such property at different rates.
2. The General Assembly is to be authorized to levy income taxes, to make the rates progressive, and to tax income not derived from property at lower rates than income derived therefrom.
3. If the General Assembly enacts a progressive income tax, the maximum rates must not be more than six times the lowest rates.
4. Exemptions from the income tax must not exceed \$500 to a person not the head of a family whose total net income is less than \$1,000, and must not exceed \$1,000 to the head of a family whose total net income is less than \$2,000.
5. Taxes paid on property must be allowed as a deduction from the tax on income derived therefrom for the same year.
6. The General Assembly is to be authorized to substitute the income tax for the property tax upon any property, i.e., wholly to exempt any property from direct taxation by valuation, if income derived from such property is taxed.
7. The levying and collecting of income taxes is to be restricted to some State authority.

¹ Const. 1870, Art. 9.

8. All the receipts from income taxes collected within each county are to be apportioned and divided between the State and the various local taxing bodies within the county, including the county itself, in the same proportion as the taxes levied upon real estate by valuation for the same year are apportioned and divided between the State and the local taxing bodies within such county.¹

The minority proposals are not substantially different from the majority proposal, except that they do not permit classification of property, and offer as the only alternative to uniform taxation of tangibles and intangibles the total exemption of intangibles from taxation by valuation, if the income therefrom is taxed.

The majority proposals, if adopted, will permit of a very substantial modernization of the Illinois tax system and should result in an elimination of at least the most glaring of the present inequalities in the assessment and taxation of property made inevitable by the constitutional prescription of uniformity of rates. Nevertheless, certain of the features of the proposals appear open to serious criticism.

It would have been better if the Revenue Committee had seen its way clear to support classification without restriction to intangible property. Differentiation in rates of taxation between land, improvements, merchandise and materials, and household effects, as well as between forestry, mining, and other lands, has much to be said for it, and may some day win the support of the legislature, but if that day comes and the foregoing proposals are in force, the legislature will find itself helpless to institute such differentiation. The authorization of the General Assembly wholly to exempt any property from direct taxation by valuation would permit the exemption of small amounts of household effects, workingmens' tools, and such like, from the property tax, if incomes are being taxed. This provision is in the right direction, and somewhat modifies the seriousness of the failure to permit thoroughgoing classification of tangibles. The taxation of household effects is always and everywhere the most irritating, unequal, and unproductive part of the property-tax system. But the provision is couched in such general terms that its adoption would be a standing invitation to special interests to attempt to obtain exemption of the kinds of property they were specially interested in whenever the amounts of property taxes to which

¹ A digest of the proposals is given in Illinois Legislative Reference Bureau, Bulletin No. 7, *Digest of Constitutional Convention Proposals*, par. 378. Cf. also, *Proceedings of the National Tax Association*, 1920, pp. 253-54, where the majority proposal is given verbatim.

they would be subject were in excess of the income taxes. If the intent of this provision is what it is claimed to be,¹ namely, to permit of the exemption of small amounts of personal property of certain limited kinds, there can be no objection to making the provision more definite and safer by restricting its application to specific types of property.

The purpose of the authorization to tax income from property at a higher rate than income not derived from property could be achieved with much less inconvenience, uncertainty, and administrative difficulty by permitting the General Assembly, at its discretion, to fix the deduction allowed from the tax on income derived from property at all *or part* of the valuation tax paid upon such property, instead of prescribing the deduction of the entire property tax from the income-tax payments. As they stand now, these two provisions are inconsistent; one provides a means of avoiding what the other is intended to accomplish, namely, the heavier taxation of persons receiving their income from property than of persons receiving their income from personal effort.

The provision to the effect that taxes paid on property must be allowed as a deduction from the tax on incomes derived therefrom should be revised, therefore, so as to be permissive and not mandatory, and also so as to leave to the discretion of the General Assembly the percentage of deduction to be allowed. Property and income provide independent bases for taxation, and each should be taxed on its own account, although, of course, not without reference to the taxation of the other. If the tax paid on property may be completely deducted from the tax paid on income derived therefrom, the property tax becomes merely a means of taxing non-income yielding property and of reaching indirectly the income of those classes of persons, such as farmers, who have incomes difficult to assess directly. In a system comprising both property and income taxes, the property tax should be utilized for these purposes, but it should also be made a means of taking into account the superior tax-paying ability of property income as compared with personal effort income, as well as the calls made upon state expenditures for the protection, policing, and other services rendered to property.

The provision that the highest rate on income shall not exceed six times the lowest rate, read with the provision that the maximum exemption from the income tax shall not exceed \$500 for a single person and \$1,000 for the head of a family, is an ingenious method of limiting the amount of progression which meets McCulloch's famous criticism of

¹ As, for instance, by Douglas Sutherland, a member of the Revenue Committee, in the *Proceedings of the National Tax Association*, 1920, p. 254.

progressive taxation, that once you depart from the proportional principle you are "at sea without rudder or compass." It is open to criticism, however, with respect to its specific details. The exemption provision is clumsily worded, and its meaning is far from clear. As it reads,¹ it apparently means that the exemptions are to apply only to single persons whose income does not exceed \$1,000 and to heads of families whose income does not exceed \$2,000. If this is so, a single person with \$1,000 income may have taxable income of \$500, whereas a single person with \$1,001 income may be taxed on his entire income. On the other hand, it may mean that persons with incomes exceeding \$1,000 for single persons and \$2,000 for heads of families may still receive exemptions, but such exemptions must be less than \$500 and \$1,000 respectively. In any case, the exemptions are too low, and the usual exemptions for dependents should also be authorized. An income tax working down to such low limits would be hard to pass through an American legislature, and if passed would be hard to collect and unpopular. Since it would be inconceivable that any attempt would be made by a state legislature to tax incomes not exceeding \$1,000 at a higher rate than 1 per cent or at most 2 per cent, the low exemptions plus the six-to-one provision for the maximum rate would operate in practice to limit the highest rates on large incomes to 6 or at most 12 per cent. This is not of itself an objectionable feature. But if the proposed amendment is really intended to make possible the moderate taxation of incomes, it should either remove all restrictions as to exemptions, or should not limit them below those granted in the present federal income tax.

The provision that receipts from income taxation within any county must be apportioned between state, county, and local districts in the same proportions as the receipts from the ad valorem taxes on real estate will operate to the relative advantage of those counties which have high county, school district, town, and other local rates. The state rate on real estate is uniform throughout the state. Consequently, the higher the local rates within any county, the greater the fraction of the income-tax receipts within that county which will be retained by the local tax bodies. Cook County will benefit from this provision.

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¹ "Not exceeding \$500 to a person not the head of a family whose total net income is less than \$1,000 and not exceeding \$1,000 to the head of a family whose total net income is less than \$2,000, may be exempted from income tax."